

## Internal Revenue Service

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Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_  
Telephone Number: \_\_\_\_\_

Refer Reply To:  
CC:PSI:B02  
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Date:  
July 23, 2009

### Legend

X =

State =

City =

Date1 =

Date2 =

Date3 =

Date4 =

a =

b =

c =

d =

e =

Dear \_\_\_\_\_ :

This responds to a letter dated June 23, 2009, submitted on behalf of X by X's authorized representative, requesting a ruling that the rental income received by X from certain rental real estate is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code (the Code).

The information submitted states that X was incorporated under the laws of State on Date1. X intends to elect to be an S corporation effective Date2. X owns and operates a shopping center in City. X derives income from the leasing of office and retail space within the shopping center to various tenants. X directly performs through its a part-time employees, or hires contractors to perform, certain services necessary for the operation of the shopping center, including maintaining and repairing the real property, through the inspection of and repairs and maintenance to the roof, external walls, floors, foundation, guttering and downspouts, plumbing, parking lot and parking lot lighting, sidewalks, curbs, and drainage ditches surrounding the parking area, and air conditioning and heating units for tenants; disposal of garbage and waste materials for tenants; performance of safety inspections and pest control inspections and treatment; providing emergency services as required; landscaping and maintenance of the shopping center grounds and parking lots; repairing storm and other casualty damage to the shopping center, including the maintenance and repair of problematic drainage areas; maintaining large pylon signage, handicapped, fire lane and no parking signage; providing and maintaining seasonal decorations and features; negotiating and signing leases, overseeing rental collections and communicating with tenants, determining appropriate rental rates and showing space to prospective tenants; investigating potential tenants for suitability; marketing the shopping center through advertising and public relations activities; and addressing tenant complaints, responding to tenant requests, and resolving disputes between tenants. X also provides insurance coverage for the shopping center.

For the taxable year ending Date3, X collected approximately \$b in gross rents and incurred approximately \$c in relevant operating expenses for the shopping center. For the taxable year ending Date4, X collected approximately \$d in gross rents and incurred approximately \$e in relevant operating expenses for X's rental real estate properties. X also represents that X has accumulated earnings and profits.

Except as provided in § 1362(g), § 1362(a)(1) provides that a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(iii)B(i) of the Income Tax Regulations provides that “rents” means amounts received for the use of, or the right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that “rents” does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in the active trade or business of renting property only if, based on all of the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all of the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

Based solely on the facts submitted and the representations made, we conclude that the rental income X receives from its shopping center operations described above is not passive investment income under § 1362(d)(3)(C)(i).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code, including whether X was or is a small business corporation under § 1361(b). Further, the passive investment income rules of § 1362 are independent of the passive activity loss rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, copies of this letter are being sent to X's authorized representatives.

Sincerely,

Bradford R. Poston  
Senior Counsel, Branch 2  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)  
Copy of this letter  
Copy for § 6110 purposes